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UNCLAS SECTION 01 OF 02 TAIPEI 000566

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SUBJECT: TAIWAN BELATEDLY ALLOWS INVESTMENT OF PENSION FUNDS

REF: 05 TAIPEI 00383

11. SUMMARY. On March 2 the Legislative Yuan passed a bill setting up the Labor Pension Supervisory Commission under the Council of Labor Affairs (CLA) which will permit the investment of the country's growing pension fund. This follows two years of bi-partisan bickering which resulted in the funds sitting in a bank collecting low interest. The ruling Democratic Progressive Party (DPP) has favored an Administrative Corporation, mixing public and private management to manage the fund, whereas the opposition KMT favors strictly public management. The LY voted in favor of public management. It is hoped that the new freedom to invest will result in much better returns for the funds and will help stimulate the economy in terms of increased investment both internally and from foreign sources. END SUMMARY

PENSION FUND BACKGROUND

12. The current pension fund was adopted in July 2005 after passage of the Labor Pension Act. Under this scheme, employers are required to pay 6 percent of the employees salary every month into individual accounts which are portable, i.e. when an employee switches jobs he/she can transfer their account to the new firm. Under the new pension system, retirees can draw an annuity rather than just be paid a lump sum at retirement. To date, more than 4.29 million workers have enrolled in the pension program and the fund has accumulated NT\$140 billion (US\$1= NT\$32.90) at the end of Feb 9, 2007. Since 2005 until now the fund has been drawing about 1.0-1.5 percent interest in the banks while the CLA waited for a final decision. It is estimated that the fund has lost NT\$6.7 billion due to lost investment opportunities. When payments begin, about 24 percent of salary will be paid by the fund and if labor insurance is added total payment can add up to 54 percent of salary for eligible retirees.

POLITICS OVER COMMON SENSE

13. Following the announcement that the LY had approved a bill allowing investment of the country's pension funds, AIT spoke with the deputy chief of the Council of Labor Affairs

(CLA), Lee Lai-hsi. Lee seemed confident that the new measure would result in the fund growing and becoming more profitable. Lee acknowledged that the public trust in fiscal management had been hurt, but he cited previous funds which CLA had managed, including the Labor Pension Fund and Old Retirement Fund and indicated that sound management had ensured a return of 5-9 percent. Lee explained that the reason why it took so long to approve investment was due to political bickering between the ruling party and the opposition. The DPP favors to manage the investments with a quasi-independent agency or administrative corporation with more freedom to operate. The KMT wanted to stick to the administrative organization giving the LY more oversight and placing the fund managers under stricter rules. In the end, the LY approved the KMT's version and the fund will be under CLA supervision.

MANAGEMENT; GOVERNMENT EXPERTS PLUS INDUSTRY ANALYSTS

14. In order to manage the fund, the pension supervisory commission intends to appoint 21 members. The chairman and vice-chairman will be appointed by the Executive Yuan. Labor groups will select 6 persons, and the remaining picked by the CLA. A total of 10 slots is reserved for scholars and experts (private sector) so that they can serve as consultants. The LY has stipulated that the working staff should comprise over 200 persons, with 60-80 familiar with accounting, finance investment and risk management but a final decision is pending. The CLA position is that such a large staff to manage the fund is excessive and that it could be done with far fewer people. A final decision has not yet been reached. The projected inauguration date is August with

TAIPEI 00000566 002 OF 002

an operational date of late 2007.

STEADY GROWTH AND FOREIGN INTEREST

15. Lee said that the road is open from now for multiple sources of investment in the fund, both local and overseas. He said there is still a ban to invest the funds in the mainland. He added that the management of the fund will be paid by the government (yearly costs of NT\$800-1,000 million) so that the fund's equity will be freely available to invest. He foresees the fund to grow by NT\$100 -150 billion reaching over one trillion in a decade with few withdrawals in the interim. Given the size and potential of the fund, it is no surprise that foreign interests have shown an avid interest in becoming investors in the fund. Because domestic sources of investment are limited, CLA believes that more than 20 percent of the fund is likely to be invested overseas. Lee said he has talked to several overseas funds and has not made a decision yet which funds he will recommend for purchase.

COMMENT

16. The passage of the pension fund supervisory act is long overdue. Political bickering aside, the management of such a huge fund by the government must be viewed with a certain amount of distrust by the public, given the poor record of fiscal oversight of banks and other financial institutions to date. However, the CLA's plan to add private sector consultants to its management team to try and manage this fund could increase confidence in the fund's long-term viability. Allowing the fund to invest locally and internationally could not only invigorate local stock markets but also help attract foreign investment to Taiwan. END

COMMENT

